

How Policy Reforms Can Help Alleviate Income Inequality in China

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About the Author

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Introduction

The past three decades have been a period of tremendous economic growth and reforms in China. And in the process of economic growth and transformation, income distribution has also undergone significant changes.

For one thing, the Chinese government's *control* over income distribution has continued to weaken, as market mechanisms have come to play an increasingly important role.

Nonetheless, many non-market factors still have an impact on incomes and their distribution. As

a result, since the early 1980s, China's income gap has, in fact, widened to a varying degree between urban and rural areas and among different geographies and demographics. Since the mid 1990s, in particular, income inequality has worsened across the country.

Income inequality in China stems from various sources, many of which can be traced back to public policy choices and constraints.

Consider, for example, the inequality that now prevails between rural and urban areas: this gap is due mostly

to restrictions on migration, as well as differences in the quality of public services, such as transfer payments for pensions, medical benefits, and so on. Industrial policies that favor certain industries over others have led to higher wages in privileged sectors. And heavy government regulation has resulted in rent seeking and corruption, which in turn have worsened income distribution and also raised questions of fairness.¹

In a global context, income inequality in China is hardly a unique phenomenon.

Indeed, over the last 30 years, most countries in the world have experienced income inequality, although it has been more severe in some than in others. A recent Organization for Economic Cooperation and

Development (OECD) report entitled *Divided We Stand: Why Inequality Keeps Rising* analyzed the changes in income inequality in 15 OECD countries.² The results show that from the mid-1980s to the mid-1990s, the Gini coefficient of disposable household income in 14 countries rose an average of 14 percent. Then, from the mid-1990s to 2005, the Gini coefficient of disposable household

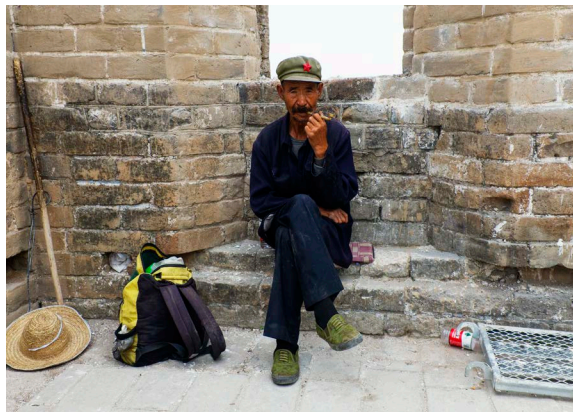


Photo: Flickr/Chris JL

income in 9 out of the 15 countries also increased, albeit at a slower rate.

But just because China is not unique in this regard does not mean its growing income inequality was inevitable or can simply be rationalized away. To the contrary, it should be noted that in some developing countries, the income gap has actually narrowed, in stark contrast to the present situation in China.

A prominent example of this phenomenon is Brazil. At the end of the last century, Brazil was one of the few countries in the world with exceptionally high income inequality. But statistics show that over the last decade or so, the situation there has improved dramatically, with Brazil's Gini coefficient declining from 0.6 in 1997 to 0.54 in 2009.³

In addition to Brazil, other Latin American countries, such as Argentina and Mexico, have also seen their income gaps narrow in the first decade of this century, generally speaking.⁴

These experiences show that even in countries with very high income inequality, something *can* be done to narrow the gap. The measures that these countries adopted to solve *their* income distribution problem could offer some lessons for China.

Ultimately, if one compares China to other countries, its income inequality problem is not the world's most severe. But the rate at which the gap is widening in China is astounding. Within 30 years, China has transitioned from an egalitarian society into a highly unequal one. Thus from a political vantage point alone, reducing income inequality has become a top priority for China. But to solve it, Beijing will need to tackle distortions in the labor market in particular.

This policy memorandum surveys the central features of income distribution in China today. It identifies structural and policy drivers that have exacerbated the problem and recommends changes, especially to China's labor market, aimed at helping the country navigate the economics of rising inequality.

Key Features of Current Income Distribution Landscape

Objectively speaking, in the last decade, the Chinese government has made considerable efforts to improve income distribution and adopted many policy measures to increase the income of poor people, especially rural residents. However, the root causes of income inequality in China—namely, the institutional and policy distortions that have helped to produce it—have not been addressed in a fundamental way. Recent statistics show that income inequality in China has remained stubbornly high, with no sign of abatement.

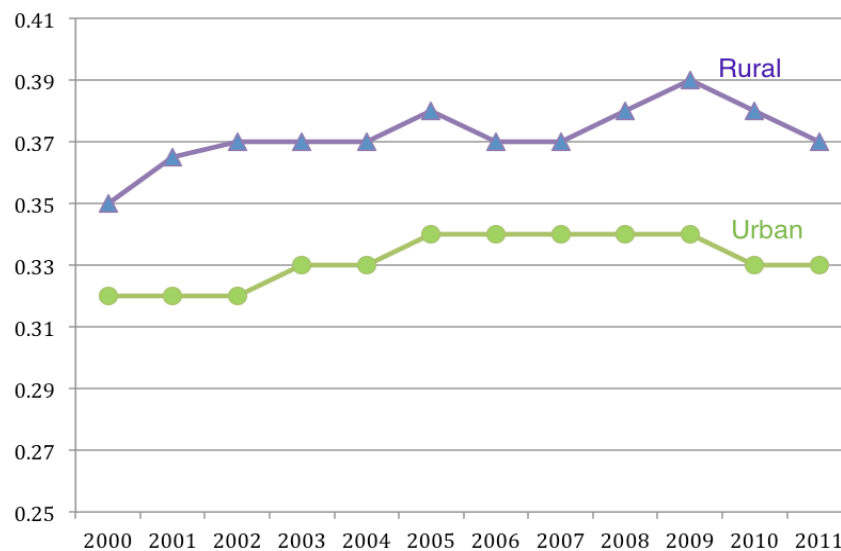
How can this be explained? Several factors have contributed to, and exacerbated, the problem.

Rural Inequality Narrows ...

It is true that *rural* income inequality, once growing rapidly, has improved overall, as the rate of growth has slowed in the past decade. Comparable data show that the rural Gini coefficient in China rose from 0.35 in 2000 to 0.39 in 2010. That cumulative increase is approximately 4 percentage points, or around 1 percent annual growth (see Figure 1).

The increase mainly happened in the first couple years of the survey. For example, from 2000 to 2002, the rural Gini coefficient rose 2 percentage points, but then slowed to below 2 percentage points for the next eight

Figure 1. China's Urban and Rural Gini Coefficients, 2000-2011



Source: Annual Report on Household Income Distribution in China 2012.

years. Indeed, since 2010, there has been a slight improvement in rural income distribution.

Many factors contributed to this slower increase, or even decrease, in rural income inequality, but the main one involves a change in the *composition* of China's rural population. Specifically, the abundance of non-farm job opportunities and the migration of excess labor from rural to urban areas helped arrest the growth of rural income inequality.

In the 1990s, rural income inequality in China widened primarily because of regional and demographic differences in non-farm job opportunities.⁵ However, in the last decade, as urbanization in China accelerated and job opportunities increased for migrant workers, their wage income as a percentage of their household income continued to rise, which slowed the widening of the rural income gap.⁶

Migration has been a central element of this change: as high-income rural families moved to small towns, the income gap narrowed in the rural areas they left behind. Land zoning policies were another factor, through which some wealthier rural areas were reclassified as “small towns.” Throughout this process, their residents were also reclassified as urban residents. This change meant that the expansion of cities reduced the number of high-income rural families, and that, in turn, also helped to narrow the rural income gap.

Based on these factors, the recent official numbers that show a slower rate of increase, or even a decline, in rural income inequality appear credible.

... But the Urban Income Gap Widens

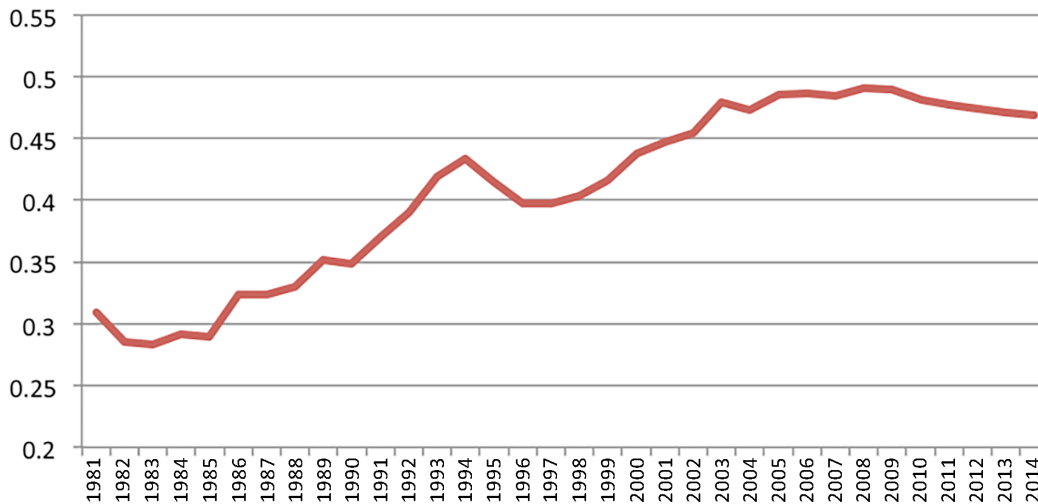
Even as the income gap in rural areas narrowed, the gap in urban areas has expanded.

Some have pointed to official figures to argue that this is not the case. For instance, Figure 1 shows that from 2000-2002, urban income inequality barely changed, with the Gini coefficient remaining flat at 0.32, according to the National Bureau of Statistics (NBS). From 2002-2005, it rose to 0.34 and largely remained at the same level over the next few years until 2009, when it declined modestly to 0.33.

Some scholars, however, argue that the Gini coefficient of urban income inequality is underestimated. For instance, as it became increasingly difficult for the NBS to include high-income households in its survey sample, high-income households were grossly underrepresented, leading to the underestimation of urban income inequality.

For the same reason, the income gap between urban and rural areas and national income inequality were also underestimated. If the data were adjusted to reflect true income distribution within the population, the urban Gini coefficient would have been approximately 0.4, larger than that of rural income inequality.⁷

Figure 2. China’s National Gini Coefficient, 1981-2014



Sources: Ravallion and Chen; Gustafsson et al.; National Bureau of Statistics.

Policy Factors

A survey of the most recent decade shows that China’s national income gap widened the most over a 50-year period.⁸ Based on NBS estimates, from 2000 to 2008, the national income gap continued to widen, with the Gini coefficient rising from 0.44 to above 0.49.⁹ While it is true that recent years have seen the national Gini coefficient decrease slightly from 0.49 in 2008 to 0.47 in 2014, whether this trend will endure remains to be seen (see Figure 2). And as already noted, high-income households are underrepresented in NBS’ data sample, thus the national income gap may have been underestimated.¹⁰

The simple fact is that China’s current national income gap is still very high—indeed, higher than at any time in the

last 60 years. After adjusting for the underrepresentation of high-income households and other biases, China’s national Gini coefficient is very likely higher than 0.5.¹¹

Policy factors deserve especially close scrutiny because, quite apart from the question of scale, income inequality in China also has a fairness dimension, which further compounds long-term social stability risks. So far, the Chinese government has not properly addressed the major policy factors underlying this critical problem of unfairness in income distribution.

One of these problems is that the income gap between urban and rural areas has resulted from historical structural distortions, and these have shown few signs of abating. Essentially, it is a

consequence of a history of policies that privileged urban development at the expense of the rural economy. Indeed, the urban-rural gap is a legacy of China's planned economy era. From the 1950s to 1970s, Beijing kept agricultural product prices at an artificially low level to support the growth of China's industrial sector. In effect, this was a policy of redistribution from rural to urban areas, or so-called "urban bias."¹²

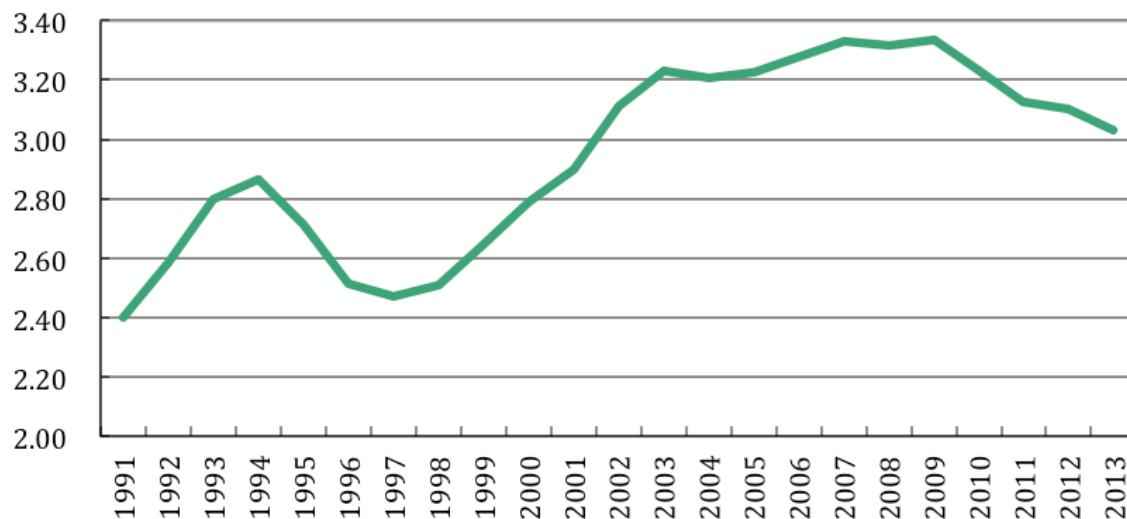
This urban policy bias has resulted in prolonged *under*-investment in rural infrastructure, the rural social safety net, and public services for rural residents. As a result, income growth in rural areas lagged far behind that of urban areas for much of the period after 1949.¹³

Such a divide persisted after dramatic economic reforms were launched in

1978 because of the existence of the residency permit (or *hukou*) system. This system controls migration by tying public services to place of legal residence, so it impeded the migration of rural laborers. In this sense, at least, the huge income gap between China's urban and rural areas is the result of an unbalanced economic development strategy, an unfair socio-economic system, and unequal system of public service provision.

The official data in recent years bear this out. The urban-rural income ratio increased from 2.78 to 3.33, widening significantly from 2000 to 2009, according to an NBS survey. This ratio peaked in 2009 and narrowed slightly over the next four years (see Figure 3). By 2013, the urban-rural income ratio had dropped to 3.0.

Figure 3. Changes in China's Urban-Rural Income Ratio



Source: China Statistical Yearbook.

Another problem, also stemming from legacy policies, is the high concentration of income in monopolistic industries. In the early 1990s, the income gap for people working in different industries and sectors was not especially big. The average salary of the highest-paid industries in China was only 30-40 percent higher than the national average. But since 2000, the salary levels within some monopolistic industries have witnessed rapid growth, and today they are much higher than the national average.

For example, in 2011, the average income of an employee in the financial industry was 94 percent higher than that of other urban employees. In Beijing alone, the average income of someone working in the financial industry was 2.3 times that of all urban employees and 3 times that of urban employees in the manufacturing industry.

Relevant research also shows that these high-income industries all have high barriers to entry. This matters because studies show that less than 40 percent of the compensation premium can be

attributed to differences in human capital; rather, the majority of the premium is because of windfall profits resulting from their monopolistic practices.¹⁴

It is also worth noting that the higher incomes in some monopolistic industries also perpetuate the rapid growth of senior executive pay. Based on a 2011 survey of the top three highest-paid senior executives across 197 large state-owned enterprises (SOEs), 35 percent of them made 0.5-1 million yuan (\$80,000-\$160,000), 8.12 percent made 1-1.5 million yuan (\$160,000-\$240,000), 5.58 percent made 1.5-2 million yuan (\$240,000-\$320,000), and 13.7 percent made more than 2 million yuan (\$320,000).¹⁵

A final policy-related factor involves corruption that generates so-called “gray income” from ill-gotten means, further reinforcing income inequality. Rent seeking activity tends to largely benefit economic and political elites, and would thus logically exacerbate existing income inequality. Indeed, empirical research shows that corruption has significantly worsened China’s income distribution.¹⁶

Deficiencies of China's Current Urbanization Policy

China needs to address these problems of income inequality now. Evidence demonstrates that serious income inequality can threaten a country's economic development and social stability.¹⁷ What is more, income inequality can lead to weak consumption and low efficiency, causing economic growth to slow. It can also make it hard for low-income people to bolster their own human capital, trapping them in a debilitating cycle of poverty with little upward mobility.

But that is not all: income inequality can corrode social trust, which in turn can trigger unrest. Most important, unequal *outcomes* make equality of *opportunity* virtually impossible to achieve.¹⁸

In the past, despite widening income inequality, China was able to maintain social stability, because of the combination of rapid economic growth and low unemployment. That is, even as income inequality rose, the income of poor people nonetheless grew in absolute terms as millions were being lifted out of poverty.

But things have changed, not least because China's economy has entered a so-called "new normal" phase where economic growth will inevitably moderate. As a consequence, China's

labor market will probably be weaker than in the past, and periods of high unemployment will become more likely. Taken together, these various factors suggest that persistence of an unchanging or expanding income gap will likely have a much bigger impact on social stability over time.

To solve the current problems of income distribution, China will need a holistic approach that includes designing a comprehensive and effective compensation and distribution policy framework but also the development of timely and equitable policy measures that curb these trends and address the problem of unequal income distribution in a fundamental way.

At this critical juncture of China's economic reform process, reforms to China's labor market should be the centerpiece of efforts to tackle unequal income distribution.

It should be noted that, for a number of years, labor income as a share of national income in China has continued to decline, especially in the decade from 1998-2007, when it dropped from 53 percent to less than 40 percent. And although it increased somewhat over the next few years, it remains at a very low level.¹⁹

Reforms to China's labor market should be the centerpiece of efforts to tackle unequal income distribution.

Given the fact that labor income as a share of national income is lower in China than the world average, the government will face an ever-bigger challenge in its effort to deal with the problem of income distribution.

Beijing needs to fix three types of problems.

Making the Market Decisive

China's November 2013 Third Plenum announced an intention to let the market play the "decisive" role in the economy. That can be applied to the problems of income inequality in several ways. But above all, letting the market, not the state, play the central role in factor (land and capital) pricing and industrial policy would contribute to the alleviation of income inequality.

Under China's current land system, local governments are the only ones who can formally convert rural land into urban land. As a result of this local government monopsony, farmers are poorly compensated in the process. So reforming the land system to allow farmers to *directly* sell their farmland through a land exchange could significantly boost rural incomes and mitigate the rural-urban income gap.

Quite apart from factor pricing, market reforms could also have a salutary effect if they replace industrial policies by fiat with market mechanisms. Currently, government regulation and entry barriers have led to high compensation in protected sectors while encouraging rent seeking and corruption.

Once entry barriers are lifted, private entities could enter these formerly monopolistic sectors, leveling profit margins and fostering competition. This would likely narrow the compensation gap between protected sectors, which use profit margins as a compensation guide, and the rest of the economy.

Worker Rights

A second challenge is for China to strengthen labor rights and reform the labor union system. The experience of developed countries shows that some kind of collective bargaining is necessary to ensure that wage growth matches overall economic growth. And in recent years, while some Chinese scholars have called for the establishment of a wage negotiation mechanism, little progress has been made on that front.

One reason for this lag is that China lacks the institutional environment needed for such a negotiation mechanism, especially



Photo: Flickr/Kalexander2010

given the fact that Chinese unions are not independent of the state and thus cannot fully represent the interests of workers. But since the majority of working class income comes from wages, it is imperative for Beijing to reform the current labor system to ensure that the income of the average Chinese advances alongside the economy writ large.

Migration and Social Policy Reforms

China also faces the challenge of reforming the systems and policies that have contributed to income inequality. Consider two examples: the highly anticipated *hukou* reform and reform of the pension system.

The *hukou* system separating rural from urban legal residents is at the root of the urban-rural income gap and is an impediment to the co-development of urban and rural areas. Likewise, the current pension system is highly fragmented, with vast differences in benefits across programs. Many have criticized this system for enlarging instead of bridging the income gap.

What is more, widespread discrimination still takes place in China's labor markets. Although officially prohibited by law, discrimination based on *hukou* status, gender, personal connections, and unequal pay for equal work abound in China today.²⁰ This creates both income inequality among wage earners and feeds the sense of unfairness in Chinese society.

Although much *has* been done and achieved over the past decade, relatively speaking there is much more that China can do to reduce the income gap.²¹ Recent efforts have focused on the following areas.

- **Minimum Living Standard**

Since 2003, the government has gradually put in place a minimum living standard guarantee program (*dibao*) that covers both urban and rural areas. By the end of 2014, about 71 million people had received this guarantee, including 19 million in urban areas and 52 million in rural areas.²² To a certain extent, this measure has helped to alleviate poverty, increase the income of poor people, and narrow the income gap.

- **Farmer Support Programs**

The government has also implemented many policies designed to benefit farmers, such as subsidies for boosting grain production, a new rural cooperative healthcare system, and a new rural pension system. These have played an important role in increasing transfers to farmers, improving their living standards and bridging the urban-rural income gap.

- **Agricultural Tax Reform**

The government has also reduced or abolished agriculture taxes as part of national fiscal reforms. This policy was first implemented in 2003, and by 2007, the tax burden on farmers had been largely removed.²³ This measure helped to increase farmer incomes and greatly

reduced the income gap in rural areas, and between urban and rural areas.

All this said, however, compared to other countries, the Chinese government has not done enough to strengthen income-related policies and measures.

For a comparative perspective, in some developed countries, the Gini coefficient of income inequality *before* adoption of redistributive policies can be as high as 0.5, but drop to 0.3 *after* their adoption, representing a decline of 20 percentage points. But in China, redistribution policies, such as the removal of the urban individual income tax, have had a much more modest impact on the

Gini coefficient—it only declined by less than 5 percentage points after the implementation of redistribution policies.²⁴

This small decline means that the Chinese government’s policies to incentivize income redistribution have had a very limited effect.

Beyond the labor market reforms noted above, several policy changes could also help to alleviate the growing problem of inequality.

Tax Reform

China’s current tax system plays a limited role in income redistribution

Table 1. Redistributive Effect of China’s Urban Individual Income Tax

Year	Pre-tax Gini coefficient	Post-tax Gini coefficient	% difference between pre- and post-tax Ginis
1997	0.301	0.296	-1.70%
1998	0.301	0.295	-2.00%
1999	0.297	0.292	-1.70%
2000	0.323	0.317	-1.90%
2001	0.324	0.316	-2.50%
2002	0.325	0.318	-2.20%
2003	0.344	0.336	-2.30%
2004	0.345	0.335	-2.90%
2005	0.325	0.342	-2.80%
2006	0.344	0.337	-2.90%
2007	0.345	0.332	-3.80%
2008	0.363	0.351	-3.30%
2009	0.347	0.335	-3.50%

Source: Xu, Ma and Li, 2012.

for two reasons: (1) the tax structure is biased because the share of direct taxes, such as individual income taxes, is too low while the share of indirect taxes, such as value-added taxes, is too high. The former could help to reduce income inequality, while the latter actually has increased income inequality in China.²⁵ (2) Individual income taxes are a form of payroll tax, thus imposing a tax on the working class, while leaving those with other sources of income untaxed.

As Table 1 shows, the role of China's individual income tax in bridging the urban-rural income gap has increased since 2005, but not by much. In 2009, individual income taxes only yielded a decline of less than 4 percentage points in the Gini coefficient of the urban-rural income gap. As a result, increasing the role of taxation in dealing with income inequality requires a change in the tax structure to, for example, decrease the share of indirect taxes.

Many new taxes can also be introduced to help deal with income inequality. Property and estate taxes are worth considering because they have had a limited role in China to date, with the property tax, for example, still in the pilot phase in a small number of cities. Collecting property taxes could increase the share of direct taxes, so that the government could in turn waive some indirect taxes conditionally and

thus inject greater vitality into China's corporate sector.

Low-Income Support Programs

As noted, China has already put in place a *dibao* program that covers urban and rural areas, but its redistributive effect has not been evident.²⁶ Based on the statistics from China's Ministry of Civil Affairs, around 52 million rural residents had received the *dibao* at the end of 2014, while the rural population of China still living in poverty was approximately 80 million. This means that the *dibao* coverage needs to be

widened if it is to have a substantial effect on poverty alleviation.

The government should also reexamine

subsidy policies, especially in those areas where local governments are constrained by low fiscal revenues. Low subsidies render the social safety net ineffective. Thus reforms could aim to increase subsidies and achieve universal coverage.

Indeed, the types of transfer payments to low-income people in China are limited. Some popular forms of subsidies in other countries have played a role in adjusting income distribution, such as subsidies for children's education (the Progreso Program in Mexico) and senior citizens (the Older Person's Grant in South Africa), but none of these are yet on the agenda of the Chinese government.

The Chinese government's policies to incentivize income redistribution have had a very limited effect.

So, in terms of transfers, the government must continue to increase welfare benefits to special and disadvantaged groups if these programs are to play a role in helping to reduce their income gap with the rest of society.

Social Security Reform

China should expand its social security system and equalize the benefits across different parts of that system. To date, China has built a national but still rudimentary pension and healthcare systems. But both systems share the same problem of unequal coverage—that is, different groups are covered by different programs, which, in turn, carry different benefits.²⁷

In terms of China's pension system, there are four different programs for civil servants, employees of public service organizations, employees of enterprises, and rural residents, with vastly different benefits contained therein. In terms of the healthcare system, civil servants and employees of public service organizations have a fully reimbursed program, employees of enterprises have a separate program, and rural residents have a new rural

cooperative program. These programs, too, offer vastly different benefits.

Over the long term, a tiered social security system that offers vastly different benefits is unsustainable. It will be the government's responsibility to solve this problem.

Poverty Support

Finally, the government should focus more on poverty reduction, so as to give hope to China's poorest people that they can have a way out of their economic conditions. Since reform and opening up began in 1978, China has achieved astounding progress in poverty alleviation. However, a large number of people are still living below the poverty line.

While the Chinese government has invested heavily in poverty reduction efforts, the results are not satisfactory, partly because the spending is not effectively targeted at the poorest of the poor. These people are, to a large extent, excluded from the economic development process. If the government aims to play a role in lifting them out of poverty, it will need to develop more effective policies and better allocate funds.

Conclusion

Without a doubt, reforms to support income distribution in China will be a daunting task, and it is inevitable that reforms will encounter various obstacles. Because of the opposition of vested interests, the progress of market reforms has been uneven. Some sectors are unwilling to give up their monopolies, so they use political influence to delay market reforms, or cherry pick the parts of a prospective reform program that are favorable to them while resisting those that are detrimental to their interests.

Public interest groups, too, have set out some obstacles for reform. For example, the announcement and implementation of property and estate taxes have been delayed over and over

again due to the strong opposition of some interest groups.

The sobering fact is, the power of vested interests and income inequality are mutually reinforcing. That is to say, the more resourceful the vested interests, the more capable they have proved to be in defending the status quo.

But this means that stalling will only make reforms more untenable. And this is especially true for the reform of China's income distribution system. Income inequality derives, in part, from problems in China's economic growth model and flaws in its economic and political systems. What is needed is comprehensive reform, especially to unshackle the political constraints that currently handicap reform efforts.

Endnotes

¹“Measuring the Width of the Wealth Gap,” *Caixin*, September 23, 2013, <http://english.caixin.com/2013-09-23/100585181.html>.

²*Divided We Stand: Why Inequality Keeps Rising*, 2011. OECD Publishing.

³Pedro H. G. Ferreira de Souza, 2012. “Poverty, Inequality and Social Policies in Brazil, 1995-2009,” Working Paper No. 87. Institute for Applied Economic Research (IPEA) International Centre for Inclusive Growth.

⁴Lustig, Nora, Luis F. Lopez-Calva and Eduardo Ortiz-Juarez, 2013. “Deconstructing the Decline in Inequality in Latin America,” Working Papers 1314, Tulane University, Department of Economics.

⁵Zhao Renwei, Li Shi and Li Siqin (eds.), 1999. *A Revisit on China’s National Income Distribution*, China Financial and Economic Publishing House.

⁶Based on the calculation derived from a survey conducted by a research group on China’s income distribution in 2002 and 2007, the concentration rate of migrant workers’ salary income in 2002 was lower than the Gini coefficient of their household income, which shows its effect on reducing the income gap. “Concentration rate” is a metric used to measure the equal distribution of a single type of income. It is different from the Gini coefficient in terms of calculation. Calculating the Gini coefficient of a single type of income requires sequencing such income, while calculating the concentration rate requires sequencing the total income. By 2007, the concentration rate of migrant workers’ salary income was even lower, which means its effect on bridging the income gap was growing. In other words, the income gap in rural areas will continue to narrow as the income of migrant workers continues to rise.

⁷Li Shi, Luo Chuliang and Shi Taili, 2013. “China’s Income Inequality and Poverty,” in Li Shi, Zuo Tenghong, and Shi Taili (eds.), *An Analysis on the Changes of China’s Income Gap*, People’s Publishing House.

⁸Li Shi, Zhao Renwei and Gao Xia, 2013. “An Analysis on the Unequal Income Distribution for Retirees Across Sectors and Over Time,” *Journal of Financial Research*, Vol 2.

⁹See Ma Jiantang’s Press Conference on the Economic Conditions of 2012, accessed at http://www.stats.gov.cn/tjdt/gitjtdt/t20130118_402867315.htm.

¹⁰Based on the estimates of Li Shi and Luo Chuliang (2011), as high income households are underrepresented in the sample, the Gini coefficient of the national income gap is underestimated by approximately 5 percentage points.

¹¹ If this is true, China has joined the ranks of those countries that suffer from high income inequality. The Human Development Report published by UNDP in 2011 listed the recent Gini coefficient numbers of 111 countries, of which 17 have a Gini coefficient higher than 0.5, accounting for 15% of the countries in the sample.

¹² Lin, Justin Yifu, Cai Fang and Li Zhou, 1999. *The China Miracle: Development Strategy and Economic Reform*, Shanghai People's Publishing House.

¹³ Shi Taili, Yue Ximing, Gustafsson and Li Shi, 2008. "An Analysis on China's Urban-Rural Income Gap" in Li Shi, Shi Taili, and Gustafsson (eds.) *Research on China's National Income Distribution III*, Beijing Normal University Press.

¹⁴ Yue Ximing, Li Shi and Shi Taili, 2010. "A Discussion on the High Income of Monopolistic Industries," *Social Sciences in China*, Vol 3.

¹⁵ "A Study on the Theories of Income Distribution and International Comparison" (research report), China Institute for Income Distribution, Beijing Normal University, May 2012.

¹⁶ For example, Chen Zongsheng and Zhou Yunbo (2001) attempted to estimate the impact of corruption on income inequality. In the 1990s, the corruption of government officials increased the national Gini coefficient by approximately 1.7%, while other illegal income increased the Gini coefficient by 3.6%.

¹⁷ Acemoglu, Daron, 1997. "Matching, Heterogeneity, and The Evolution of Income Distribution," *Journal of Economic Growth* 2 (1), 61–92.

¹⁸ Vandemoortele. "Inequality and Gresham's Law—The Bad Drives Out the Good," background paper prepared for the UN Country Team in China, January 2013.

¹⁹ From 2007 to 2012, the share of labor remuneration increased from 39% to 46%. However, it is still lower than the level of the mid-1990s.

²⁰ "Unequal pay for equal work" refers to the practice that some SOEs offer different pay for their employees based on their status, even if they have the same job responsibilities. For example, some Chinese SOEs use a large number of temporary workers. They have the same job responsibilities as the full-time employees, but get lower pay and no social security benefits.

²¹ Li, Shi and Terry Sicular, 2014. "The Distribution of Household Income in China: Inequality, Poverty and Policies," *The China Quarterly* 217 (Mar 2014): 1-41.

²² Ministry of Civil Affairs Quarterly Social Service Statistics (4th quarter, 2014), accessed at <http://files2.mca.gov.cn/cws/201501/20150129172531166.htm>

²³ Sato Hiroshi, Li Shi and Yue Ximing, 2008. “The Redistributive Impact of Taxation in Rural China, 1995-2002: an Empirical Study Using the 1995-2002 CASS CHIP Surveys” in Gustafsson, Bjorn, Li Shi and Terry Sicular (eds.), *Income Inequality and Public Policy in China*, Cambridge University Press.

²⁴ Wang, Yake and Li Shi, 2013. “The Redistributive Impact of Taxation and Transfers,” Working Paper No. 3, China Institute for Income Distribution, Beijing Normal University.

²⁵ Nie, Haifeng and Yue Ximing, 2012. “The Redistributive Impact of Indirect Taxation on Urban Residents,” *China Economic Quarterly*, Vol 12, No. 47(01).

²⁶ Li Shi and Yang Sui, 2009. “The Impact of Urban Minimum Income Subsidies on Income Distribution and Poverty,” *Chinese Journal of Population Science*, Vol 5.

²⁷ Li Shi, Zhao Renwei and Gao Xia, 2013. “An Analysis on the Unequal Income Distribution for Retirees Across Sectors and Over Time,” *Journal of Financial Research*, Vol 2.

About Policy Memoranda

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Policy Memoranda offer background and analysis of a discrete policy challenge but, most important, offer realistic, concrete, and achievable prescriptions to governments, businesses, and others who can effect tangible and positive policy change.

The views expressed in Paulson Policy Memoranda are the sole responsibility of the authors.

About The Paulson Institute

The Paulson Institute, an independent center located at the University of Chicago, is a non-partisan institution that promotes sustainable economic growth and a cleaner environment around the world. Established in 2011 by Henry M. Paulson, Jr., former US Secretary of the Treasury and chairman and chief executive of Goldman Sachs, the Institute is committed to the principle that today's most pressing economic and environmental challenges can be solved only if leading countries work in complementary ways.

For this reason, the Institute's initial focus is the United States and China—the world's largest economies, energy consumers, and carbon emitters. Major economic and environmental challenges can be dealt with more efficiently and effectively if the United States and China work in tandem.

Our Objectives

Specifically, The Paulson Institute fosters international engagement to achieve three objectives:

- To increase economic activity—including Chinese investment in the United States—that leads to the creation of jobs.
- To support urban growth, including the promotion of better environmental policies.
- To encourage responsible executive leadership and best business practices on issues of international concern.

Our Programs

The Institute's programs foster engagement among government policymakers, corporate executives, and leading international experts on economics, business, energy, and the environment. We are both a think and "do" tank that facilitates the sharing of real-world experiences and the implementation of practical solutions.

Institute programs and initiatives are focused in five areas: sustainable urbanization, cross-border investment, climate change and air quality, conservation, and economic policy research and outreach. The Institute also provides fellowships for students at the University of Chicago and works with the university to provide a platform for distinguished thinkers from around the world to convey their ideas.

Paulson Policy Memorandum

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